



SOCIETY OF ACTUARIES

Article from:

Small Talk Newsletter

June 2005 – Issue No. 24

Product Development Consideration for a Simplified Issue Product

by Edward Hui

Recently, there has been an increase in the product development of simplified issue (SI) products in the United States. In the past two years, Gen Re LifeHealth has reviewed over 40 such products, ranging from vanilla direct-marketed products to high-end single premium immediate annuity (SPIA) paid universal life products.

The growth in SI product can be largely attributed to new markets, new underwriting and the current economic environment. Non-traditional markets continue to grow, particularly in the financial sector. Insurance companies are looking to expand through investment broker and financial advisor channels and banks are looking to grow their presence in the insurance market. These channels have ready access to the wealthy and “baby boomer” markets and companies need SI products that are simple, easy to sell and fit well with their portfolio of products. Also, new tools have emerged recently, such as oral fluid tests, teleunderwriting and pharmacy database underwriting. Many of these new underwriting tools are fast, simple and non-invasive. For some SI products, applications can now be processed in less than 24 hours. Finally, the current economic environment of high costs and low interest rates have prompted some employers to use work-site products, to help improve mortgage term sales.

The combination of these items along with the occasional exciting new markets has helped breach new markets with a potential for higher growth. However, an SI product is often riskier than a fully underwritten product. It is important to stress that although SI products are simple products, due diligence is key to development



and ongoing profitability. Said another way, do it well or not at all.

Principal Risks

SI products are essentially simple products in a nontraditional market with simplified underwriting. So the two main risks are market penetration risk and underwriting/mortality risk. Gen Re has seen instances where actual volume was one-tenth of the level expected by the direct company, and where mortality and lapse rates were well over double the assumptions used. For example, an SI product (not a burial expense product) was reviewed where experience ran at over 300 percent of the 65-70 Society of Actuaries' Ultimate Table due to liberal underwriting. At these levels, estimating mortality can be more of an art than a science, and with the resulting high premiums, there comes a point where one might ask whether the product is worthwhile to healthy policyholders. We have also seen accounts where there was a high volume of business with better than expected mortality and lapse rates. In all of these examples, results could have been improved with better initial and ongoing due diligence.

Where SI Makes the Most Sense

To those looking to reach a market with a new SI product, I have the following recommendations:

- **Niche Markets**
SI programs work best in niche markets. There are at least two requirements: a market with preferred risks, and a market where a fast, simple sale is needed. Preferred risks can be groups, such as those actively at work, those with mortgages, the wealthy or affinity groups. Preferred markets are an excellent means of mitigating the risk of high anti-selection, while groups without preferred risk lead to heavy anti-selection. Groups that do not need a fast and simple sale will not accept the trade-off or higher premiums.
- **Definite Value to the Customer**
The product should fulfill customers' needs and be reasonably priced relative to competitors in that market and other similar markets. If customers do not believe the product has reasonable value, healthy lives will switch to the next fast/simple product that has more value. Ensuring value to the customer will limit selective lapses and unwanted distribution risk.
- **Sellable to the Field Force**
Make sure that the SI products are understood by producers and fit with their portfolio of products. Financial agents do not want to jeopardize the client relationship if



insurance coverage is denied, particularly when insurance is secondary to the relationship (in many cases, prescreening helps preserve the relationship). Thus, having the commitment of producers increases the chances that desired premium levels are achieved.

Underwriting

The backbone of an SI program is underwriting. With existing SI markets, underwriting is based largely on existing guidelines and tools. However for new SI markets, determining underwriting guidelines and tools can be quite a challenge. Even for existing SI markets, staying abreast of new risks and underwriting tools is necessary to ensure that the product continues to perform well.

Choosing the right tools. Today there is a wide range of underwriting tools for SI programs, including teleunderwriting, motor vehicle reports, oral fluids and pharmacy database underwriting. To maximize performance of the product, consider the process in Figure 1 on page 8. The key points are to identify market needs and risks, evaluate and choose the tools, set limits, estimate morality and keep adjusting and stress testing price until profit measure are most supportable.

Producer concerns. When evaluating underwriting needs of the market, producers are looking for speed, price, approval rates and administrative ease of underwriting. For approval rates, in certain markets it is very important that the SI product could be sold to almost all potential buyers. When considering administrative ease of underwriting, think about whether underwriting is transferable to an agent and whether or not it is invasive.

Risk profile of the market. Assessing the risk profile of the SI market is crucial to choosing the right underwriting. For a fully underwritten product, the level of underwriting adjusts depending on the risk level. For example, a \$10 million application on a 65-year-old would have much higher levels of underwriting than a \$100,000 application on a 35-year-old. With SI products, there is often just one level of underwriting (hopefully targeted to one tightly defined market, so the risk profile of the market needs to be very well understood when setting underwriting requirements). AIDS, alcohol abuse and avocations are big risks at younger ages; for older ages, the principal risks are related to medical conditions. Impairments such as cancer, heart attack and stroke can still present a high risk five years or longer after policy issue, so when appropriate, be sure the questionnaire extends beyond five years. It is also key to know what type of anti-selection is common in your market. How valuable is the sentinel effect? Will there be selective lapses due to other more competitive products? What is the distribution risk of this product if there is a high concentration at older ages, large amounts and highly residual standard cases?

Assessing the risk profiles of the SI markets is crucial to choosing the right underwriting.

Popular underwriting tools. When evaluating and choosing underwriting tools, consider protective value, cost, speed and administrative ease of underwriting. Depending on the needs and risks of the market, each program will weigh these four factors with different importance. The most popular underwriting tools for SI products are listed on page 9:

- Application
- Attending physician's statement (APS)
- Home office (urine) specimen (HOS)
- Medical Information Bureau (MIB)
- Motor vehicle report (MVR)
- Oral fluid testing
- Pharmacy database underwriting
- Teleunderwriting

Setting limits. Finally, once the underwriting tools are chosen, determine age, amount and table rating limits. Limits will be raised by market needs and restrained by the risk profile and price of the product in the specific market. Distribution risk and anti-selection are always concerns when setting limits: however, there could be alternative modifications such that both parties (applicants/agents and insurers) are satisfied. If a high approval rate is very important for the product, consider including a conservative sub-standard class. If older ages or higher amounts are key, consider offering lower policy amounts at older ages.

Overall Profitability

The previously mentioned considerations focus on developmental stages of the SI product. However, continued risk management is equally important. SI products have the risk of high mortality, so mortality, lapse rates and distribution experience should be continually monitored. Producer's needs, emerging underwriting tools and the fast-changing competitive environment should be monitored to prepare for the next version of the product. ●

Edward Hui, FSA, MAAA,
is a pricing actuary for the
individual life division at
Gen Re LifeHealth in
Stamford, Conn. He can
be reached at ehui@
genre.com

continued on page 8 ►►

▶ continued from page 7

**Figure 1:
Process for Maximizing Product Performance**

